THE CONVERSATION

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Payday lenders are out of time in their fight against credit cap

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They're tempting and easy but payday loans are certainly not cheap. Scurzuzu

Pressure is mounting on high cost credit companies to face tighter controls when they hand out short-term loans. Debt advice agencies, consumer organisations, anti-poverty campaigners and a cross-party group of MPs have all joined calls for the Financial Conduct Authority to regulate the market when it starts work in April 2014.

A charter has now been published on the subject and the Labour Party has raised the political stakes by promising to introduce a cap on the cost of credit if it wins the next election.

Growing debt, growing problem

Payday loans are the fastest growing part of the high cost credit market, having doubled in value from £900m in 2009 to £2.2 billion in 2012. Designed for short-term use, they have stunningly high Annual Percentage Rates (APRs). Loan company Wonga, for example, offers an APR of 5853% in the "representative example" shown on its website. APR is not an ideal measure for loans that are meant to be paid back in a matter of weeks but if borrowers default, the costs soon mount up. The total amount also rises with additional fees, on which interest continues to accrue.

Recommendations made in recent research on debt in low income households in the

Teesside area of North East England endorse this call for greater regulation – and not just over payday lending but all high cost credit. The two-year research project was a partnership between Durham University's Centre for Social Justice and Community Action, community organisation Thrive Teessideand Church Action on Poverty. Funded by the Northern Rock Foundation, the project worked with 24 households, gathering information on household finances and attitudes towards money before offering financial mentoring. The research found that doorstep loans, rent-to-own stores and catalogues were the most commonly used forms of high cost credit in these households.

High cost credit was readily available and frequently offered with no checks on what other loans a borrower might already have taken out or whether they could afford repayments. For example, Claire, a single mother with four children, had more than 30 different loans amounting to £15,000. She was paying £270 a week to various doorstep loan companies. After working with her mentor, she reduced her repayments and reported no longer breaking down with worry about her debts.

If Claire's recent lenders had conducted proper affordability checks and were only allowed to lend if she could afford repayments, they would not have given her loans. Some might argue that this would cause problems for Claire, who might need short-term credit to buy essentials and tide her family over lean periods. But Claire herself said that she would never borrow money again from high cost lenders.

Action is overdue

Other sources of loans and support are needed for people who have a poor credit record and no savings. There are plans to develop the services offered by credit unions and community development finance institutions so that they can offer loans at much lower rates than high cost credit companies but at higher rates than usually charged by credit unions. This would allow for greater levels of default and higher costs of collection of repayments. The modernisation and expansion of credit unions will be a slow process and a £38 million government-funded expansion scheme is still just a drop in the ocean compared with the profits made by high cost credit companies.

Tackling the high cost credit problem will take action on several different fronts. Those who turn to these loans need access to low cost alternatives and neighbourhood-based financial capability training, mentoring and debt advice.

But positive action can only work against a backdrop of greater government regulation. A report from the Centre for Responsible Credit, shows that the "real-time regulatory databases" operating in some US states are a potential option. These require lenders to log loans and repayments in a database so that affordability checks and other regulations can be enforced. Some states cap either interest rates or the total cost of credit.

UK-based high cost credit companies argue against a cap on the total cost of credit, claiming that this will put them out of business, remove a valued source of credit from people on low incomes and encourage the growth of illegal loan sharks.

However, the CfRC research shows that in some of the states with caps on credit, payday loan companies still operate with a profit. The time is now ripe for the new Financial Conduct Authority to tackle the high cost credit companies in the UK head-on.